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S E C R E T SECTION 01 OF 04 BRASILIA 001242

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TREASURY FOR SECRETARY PAULSON  
TREASURY FOR OASIA - DAS LEE AND J.HOEK  
STATE PASS USTR

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TAGS: ECON PGOV EFIN BR

SUBJECT: SCENESETTER FOR THE JULY 9-11 VISIT OF  
SECRETARY PAULSON TO BRAZIL

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Classified By: Acting Economic Counselor J. Andrew Plowman,  
reasons 1.4 (B) & (D)

¶1. (C) Summary: The U.S. and Brazil share the basic goals of fostering hemispheric stability, promoting democracy, achieving a mutually satisfactory conclusion to the Doha round of WTO negotiations, preventing terrorist and drug transit activity and strengthening international non-proliferation regimes, but U.S.-Brazil cooperation is sometimes limited by the GOB's unwillingness to speak out against anti-democratic actions by the Venezuelan regime, engage in free trade or defense cooperation negotiations, or take proactive steps to address proliferation and counterterrorist concerns. Brazil has maintained its leadership role in the Haiti peacekeeping force but has not yet used that as a launching pad to greater international leadership on democracy promotion or security issues.

¶2. (C) All too often, Brazil confines itself to South-South platitudes, or lets others take the lead, as in the recent takeover of the Mercosul agenda by Venezuela's Hugo Chavez. Brazil's status as a leader in biofuels, combined with the March 2007 signing our bilateral MOU on biofuels cooperation, offer a potential avenue for increasing bilateral cooperation in a strategically important area. The two presidential summits in March 2007 (Sao Paulo and Camp David), combined with several instances of reckless overreaching by Chavez, including Chavez's criticism of Brazil's ethanol policies and the signature of our MOU, have created a positive change of tone in our bilateral conversation. Despite their growing concern over Chavez's regional role, the Lula Administration clearly believes that it must maintain its distance from the USG in order not to compromise its perceived ability to work with Venezuela and its regional allies, including Bolivia.

¶3. (C) On the economic front, Lula's cabinet choices, which saw all three key economic ministers -- Finance Minister Mantega, Planning Minister Bernardo and Central Bank President Meirelles - keep their jobs, has confirmed Lula's intent to maintain policy continuity. In January, Lula unveiled his Growth Acceleration Program (PAC), a mish-mash of public investment promises and targeted tax breaks aimed primarily at construction and certain high tech sectors, which has become the economic policy centerpiece of his second administration. Although the PAC contains many measures of incremental merit, it fails to

seize the opportunity presented by the current benign economic environment to tackle some of the growth-limiting distortions in the economy, such as the spendthrift fiscal system, burdensome tax structure and onerous labor regulations. Lula's social programs, combined with formal sector job growth and real increases in the minimum wage, have reduced income inequalities each year since 2004. More needs to be done to increase economic growth, however, to lift the masses out of poverty.

End Summary.

**¶4.** (C) While the attainment of a permanent seat on the UN Security Council has been a central tenet of Brazil's foreign policy under President Lula da Silva's government, Brazil has largely failed to assume the international leadership role that would make it a strong candidate for such a position.

Unfortunately, the GOB has not used its laudable contribution to stability in Haiti as a first step along the road to becoming a champion of international peace, security and stability.

Brazil's latest two-year stint on the UNSC, which ended in January 2006, was characterized by caution and equivocation rather than vision and leadership. Its foreign policy in general has often been dominated by symbolic steps to burnish its South-South credentials rather than by resolute attention to its core political and economic interests, including strengthening bilateral political and trade relations with The United States. The GOB, along with India, has led the G-20, a group of developing nations coordinating negotiating positions for the WTO Doha Round. The group's widely varying membership has made it difficult for them to reach consensus on negotiating positions; some group members recently presented their own alternative proposal on Non-Agricultural Market Access (NAMA), in an implicit slap at Brazil and India's leadership.

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Friendly Cooperation, But Not Strong Friendship

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**¶5.** (C) Brazil's democratic institutions are generally strong and stable, and the military dictatorship that ended over 20 years ago is not likely to reappear, as Brazil's armed forces today pursue a professional non-political identity. With steady (though not spectacular) export-led economic growth having become the norm in the recent past, Brazil has been a supporter of reasoned foreign policy goals and has been steadfast in its support of democracy in the hemisphere. It has a strong interest in hemispheric security issues that largely mirrors our own, and actively cooperates with us on the operational level in the fight against terrorism and drug trafficking.

**¶6.** (C) However, while the GOB has pursued generally friendly relations with the U.S., the current left-of-center administration has studiously avoided close cooperation with us on broad strategic issues important to us, and has kept us at arms length on most security-related issues. Specifically, the GOB has refused to negotiate a Defense Cooperation Agreement or Article 98 agreement, or to agree to broad protections for servicemembers participating in joint exercises. In addition, despite President Lula's active pursuit of high-level U.S. cooperation on achieving a successful result in the ongoing WTO trade talks, he has publicly said that the Free Trade Agreement of the Americas (FTAA) is not on his agenda. While Brazil would like to gain greater effective access to the U.S. agricultural market, it stubbornly refuses to recognize that it would need to reduce its industrial tariffs (its average MFN tariff is 11 percent) and barriers to service exports to obtain this. Small and medium size producers here continue to fear competition from the U.S.

**¶7.** (C) Our bilateral dialogue with the GOB on development assistance to Brazil and in third countries contains positive elements, including promising potential in biofuels, but is constrained by differences in approach to anti-poverty efforts, with the GOB focusing on cash transfers, while the USG prefers more finely targeted assistance. The Brazilian Government's

multi-billion dollar poverty alleviation program -- Bolsa Familia -- receives technical assistance from the World Bank and IDB, but USG budget constraints and the fact that it is a cash transfer program (albeit with conditions) keep us out of the initiative. USAID, for its part, has sought to target its efforts in Brazil towards promoting sustainable livelihoods through working on issues such as health, the environment and small and medium-sized enterprises. The Embassy was recently informed of plans to decrease USAID's budget in FY08 to USD two million, from its current level of USD eight million. Such a decrease in funding would severely impact our ability to continue an effective USAID mission. The GoB also has reacted poorly to our flagship environmental program, the Amazon Basin Cooperation Initiative.

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Lula's Re-Election Won't Change Policies  
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¶ 8. (C) Having survived a nearly year-long investigation of several scandals impinging on his administration, President Luiz Inacio Lula da Silva was handily re-elected to a second term in October 2006. We expect that his second term, which began officially on January 1, 2007, will look much like the first. We expect him to continue the conservative monetary and fiscal policies that characterized his first term, while taking some steps (notably his recently announced accelerated growth program) to try to bring Brazil's growth rate above the 3 percent level where it has been stuck for the past five years. Achievement of the GOB's goal of sustained five percent growth, however, will require the Lula Administration to take steps that it is otherwise loathe to do, i.e., moving forward on fiscal, labor and tax reform, revamping its social security system and giving the Central Bank true independence. In foreign policy, the GOB appears poised to favor building ties with developing nations over improving relations with the United States and other developed nations. The foreign policy team of FM Amorim, Vice Minister Pinheiro Guimaraes and Presidential Adviser Marco Aurelio Garcia will likely remain in place.

¶ 9. (C) It is worth noting that the caution and legalistic

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approach which has characterized Brazil's approach to international issues predates the Lula administration and will outlive it. We should not expect a significant shift in Brazil's traditional reluctance to work closely with us on those issues most critical to our interests. In addition, while Lula has occasionally made comments to indicate he would be open to finding creative ways to increase bilateral trade with the U.S., Brazil remains constrained by Mercosul in any commercial dealings with the United States. Venezuelan President Chavez's current participation in the group will make it impossible for Mercosul to engage itself seriously with the United States anytime soon.

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Not Speaking out on CT or Non-Proliferation  
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¶ 10. (S) Brazil's general desire not to be too closely identified with the U.S. is borne out in the GOB's approach to counterterrorism and non-proliferation. Cooperation remains good at the operational level, and we regularly obtain valuable information from GOB sources on terrorism. However, the GOB political leadership has refused to publicly endorse U.S. counterterrorism initiatives and has insisted that official communiques of the 3 plus 1 mechanism note that there is no evidence of terrorist operations in the Tri-Border area, where Brazil, Paraguay and Argentina meet. Wary of its large, prosperous and influential Arab population, the GOB makes every effort to downplay in public even the possibility of terrorist fund-raising going on inside Brazil. The Brazilian Foreign Ministry was sharply critical of U.S. designations of several Brazilian residents and individual nationals as terrorist fund-raisers around the time of last December's 3 plus 1

plenary. Indeed, the Minister of Justice told visiting Attorney General Gonzalez that the GoB would react very poorly should the U.S. designate additional Brazilian residents without first sharing with the GoB evidence to support U.S. claims. The GOB has been outspoken in its criticism of Israel's 2006 invasion of Lebanon, which claimed the lives of at least seven Brazilian citizens of Lebanese descent, and U.S. support for same exacerbated Brazil's reluctance to publicly support the global war on terrorism.

¶11. (C) The GOB is very cautious about taking an active role in some high-profile non-proliferation efforts, questioning the effort to refer Iran to the Security Council until the vote in the IAEA had become a foregone conclusion. Brazil has also not yet signed the NPT Additional Protocol, although it has not ruled out signing it in the near future. Brazil remains an active partner in the DHS's Container Security Initiative and has expressed approval of the Proliferation Security Initiative (PSI). However, the GOB has not yet endorsed the PSI statement of principles. A March 2006 DVC with experts in Washington addressed all the issues the GOB has with PSI, and those same concerns were addressed during the November 2006 bilateral Pol-Mil talks in Washington. We are still waiting to hear whether the GOB will now endorse the PSI principles.

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Biofuels -- Potential for Strategic Cooperation  
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¶12. (U) The success of Brazil's ethanol program has made it a model for the world in terms of alternative energy and presents the potential for bilateral cooperation on an important strategic issue. Brazil's comparative advantage is its ability to inexpensively produce ethanol from sugarcane, which has the highest starch content of any plant stock. Cane requires less processing than ethanol produced from corn -- which is the method used in the U.S. to manufacture ethanol. According to the World Bank, at current prices, Brazil can make ethanol for about one US Dollar per gallon, compared with the international price of about USD 1.5 per gallon for gasoline.

¶13. (SBU) Since the 1980's Brazil has attempted, without great success, to promote ethanol fuel exports to the United States. U.S. tariffs and charges make Brazilian imports uncompetitive. In addition to import tariffs of 1.9 to 2.5 percent, the U.S. imposes a 54 cents-per-gallon charge on ethanol imported for use as fuel. These charges must be paid by countries not covered by

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free trade agreements or other trade preference arrangements. Given the requirements of its fast-growing domestic market, it is unclear whether Brazil could produce enough ethanol to supply international markets. Some estimates indicate that Brazil could increase its sugarcane acreage by no more than twenty percent over the next three to four years. The GoB is eager to implement the bilateral MOU on biofuels, signed on the margins of President Bush's March 2007 Sao Paulo visit. The MOU envisions promoting biofuels production and use in certain Caribbean and Central American Countries, scientific cooperation and promotion of a worldwide trade in biofuels as commodities

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